Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of SBC Communications Inc. Petition for Waiver of Section 61.42 of the Commission's Rules	WC Docket No. 03-259

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

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I. Introduction and Summary

The Commission should grant SBC's petition for a waiver so that it may include its existing and future packet-switched services under price-cap regulation.

Packet-switched services were excluded from price caps nearly 15 years ago because such services were still in their infancy – they were not part of the Commission's original investigation of LEC productivity and represented a "very small fraction of the LECs' federally-tariffed activities." Since that time, the Commission has permitted price-cap LECs to treat *new* packet-switched offerings as "new services" under the price-cap rules. Although SBC has not opted to avail itself of this option, it is lawfully entitled to do so under the Commission's established precedent. SBC now wishes to include its packet-switched services under price caps, and, although it does not believe a waiver is required to do so, it has filed this petition out of an abundance of caution.

As SBC's petition demonstrated, even assuming a waiver of the Commission's rules is necessary here, SBC plainly meets the standard for such a waiver under Section 1.3 of the Commission's rules. Packet-switched services have been provided under price caps by other LECs for years and now account for a large and rapidly growing share of all telecommunications services. Thus, the original rationale for excluding these services from price caps no longer applies. Moreover, while competition is not a prerequisite for including a service under price

caps, the fact that packet-switched services are intensely competitive, as the Commission has repeatedly found, cannot be squared with a decision to subject these services to greater regulatory impediments than price-cap services. At a bare minimum, the Commission must extend packet-switched services the same regulatory flexibility it applies to non-packet-switched services under price caps. This will facilitate SBC's ability to deliver new and innovate services to consumers, the very benefits the price-cap rules were meant to promote.

Tellingly, the only party that opposes SBC's petition is AT&T, which is the nation's largest provider of many of the packet-switched services at issue here. AT&T has no answer to the fact that the Commission has long permitted other price-cap LECs to include packet-switched services under price-caps. Indeed, AT&T has previously argued that all LEC packet-switched services *should be included* under price-caps. AT&T nonetheless argues that there is inadequate competition for packet-switched services, but that is both irrelevant – because price-cap regulation is a mechanism for achieving competition, not a reward for doing so – and wrong, as the Commission has repeatedly found. AT&T also argues that allowing SBC to include packet-switched services within the special access basket could lead SBC to raise the prices for the existing services in that basket. But there is no need for the Commission to address these grossly speculative concerns here, which in any case are at odds with the Commission's prior rulings.

II. SBC Does Not Need A Waiver To Include New Packet-Switched Services Under Price Caps.

In the *1990 Price Cap Order*, the Commission excluded packet-switched services from price-caps on the grounds that such services "were not subject to scrutiny as part of our investigation of LEC productivity," and given that these services "represent a very small fraction of the LECs' federally-tariffed activities."[1] Although that decision did not address any specific packet-switched services, Rule 61.42(f) requires LECs to "exclude from its price cap baskets

[1] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶¶ 195, 197 (1990) ("*1990 Price Cap Order*").

such services or portions of such services as the Commission has designated or may hereafter designate by order." 47 C.F.R. § 61.42(f).

One arguable interpretation of the *1990 Price Cap Order* was that it excluded from price caps both packet-switched services that existed as of 1990, as well as any packet-switched services introduced after that date. But the Commission has consistently interpreted that order to exclude only the former. Thus, the Commission has permitted price-cap LECs to treat *new* packet-switching services – that is, packet-switched services introduced after 1990 – as "new services" under Rule 61.42(g).[2] Pursuant to that rule, price-cap LECs are permitted to include new packet-switched services "in the affected basket at the first annual price cap tariff filing following completion of the base period in which they are introduced." 47 C.F.R. § 61.42(g).

Consistent with this, a number of price-cap LECs – including BellSouth and Verizon – have included their new packet-switched services under price caps, treating them as new services under rule 61.42(g). For example, the packet-switched services at issue in the *BellSouth Pricing Flexibility Order* were "included in BellSouth's trunking basket since July 1996, pursuant to section 61.42(g) of the Commission's rules." *BellSouth Pricing Flexibility Order* ¶ 15. Likewise, the *Verizon Waiver Order* involved a waiver to *exclude* packet-switched services from price-caps, indicating that such services were included under price caps for several years pursuant to section 61.42(g). *See Verizon Waiver Order* ¶ 8.

Although SBC has historically chosen to treat it own packet-switched services differently from these other LECs, SBC now wishes to change its policies and avail itself of the same regulatory flexibility that these other similarly-situated carriers have enjoyed for many years. As SBC explained in its petition, it seeks to include the existing and future packet-switched services provided by certain SBC incumbent telephone companies under price caps in the special access basket, high capacity/DDS service category. *See* Petition at 1. Given that the Commission has

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[2] *See, e.g., BellSouth Petition for Pricing Flexibility for Special Access and Dedicated Transport Services*, Memorandum Opinion and Order, CC Docket No. 01-22, ¶ 15 (Oct. 3, 2001) ("*BellSouth Pricing Flexibility Order*"); *Verizon Petition for Interim Waiver of Section 61.42(g) of the Commission's Rules*, 18 FCC Rcd 6498, ¶ 8 (2003) ("*Verizon Waiver Order*").

consistently permitted other price-cap LECs to include new packet-switched services under price caps, and has never before required a waiver to do so, no waiver should be required here. That should be the end of the matter.[3]

III. Even Assuming a Waiver Is Required, SBC Easily Meets the Standard For Such a Waiver.

Although SBC does not believe Rule 61.42(f) prevents it from including packet-switched services under price caps, in an abundance of caution SBC has filed this petition for a waiver of that rule. Section 1.3 authorizes the Commission to grant such waivers for "good cause shown," which courts have interpreted to require "special circumstances" that "granting such relief would not undermine the underlying purpose of the rule requirement in question and would better serve the public interest than insisting on strict compliance."[4] This standard is easily met here.

First, the Commission's original rationale for excluding packet-switched services from price-cap regulation – that such services were not part of its original investigation of LEC productivity and represented a very small fraction of ILEC services – is no longer valid.[5] In the years since the Commission's decision, it has had the opportunity to evaluate innumerable packet-switched services, and at least in the case of BellSouth and Verizon has done so in the price-cap framework. Moreover, packet-switched services, while barely a blip on the radar in

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[3] In a footnote buried on the last page of its comments, AT&T claims (at 13) that the *BellSouth Pricing Flexibility Order* is irrelevant here because "no party challenged BellSouth's decision to include ATM and frame relay services within its trunking basket price cap index." But that merely demonstrates that it is permissible for a LEC to treat packet-switching services as new services under price caps, that there is no legitimate objection to that policy, and that AT&T's objection here is nothing more than a misguided attempt to raise SBC's entry barriers. Likewise, AT&T's claim that the *Verizon Waiver Order* is inapposite because it involved an interim waiver under unique circumstances completely misses the point. That case is relevant not as precedent for when it is appropriate to grant a waiver, but because it demonstrates that such waivers are not needed in the first place.

[4] *EchoStar Communications*, Hearing Designation Order, 17 FCC Rcd 20559 ¶ 94 n.299 (citing *WAIT Radio v. FCC*, 418 F.2d 1153, 1157 (D.C. Cir. 1969); *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990)).

[5] Indeed, packet-switched services are very different from virtually all of the other services that the Commission excluded from price caps in 1990, which the Commission characterized as "services offered on a one-time or contract basis that do not lend themselves to an ongoing incentive-based regulatory system." *1990 Price Cap Order* ¶ 16; *see id.* ¶ 191.

1990, now represent a large and increasing share of SBC's services.[6] All kinds of customers, both residential and business, are now migrating to packet-switched services for everything from high-speed Internet access to voice services.[7] To the extent these services remain regulated at all, they clearly should be treated the same as the services they are rapidly replacing.

Second, excluding packet-switched services from price caps would not only fail to serve but would undermine the very purpose of the price-cap scheme. As the Commission has noted, it "adopted price cap regulation in part to encourage price cap LECs to innovate, and to deploy new services." *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 37 (1999) ("*Pricing Flexibility Order*"). As SBC demonstrated in its petition, this objective is thwarted if packet-switched services are excluded from price caps because SBC is required to make a cost support showing and provide 15 days notice every time it introduces a new packet-switched service or modifies an existing one. *See* Petition at 8.[8] As the Commission has recognized, such rules "can place price cap LECs at a competitive disadvantage" because it gives competitive LECs advance notice of the price cap LEC's service offerings, giving it the chance to "begin offering the service before the incumbent

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[6] *See, e.g.*, SBC Press Release, *SBC Communications Introduces IP Product Portfolio to Serve Enterprise Customers Nationwide* (Nov. 20, 2003) ("In the coming years, businesses will continue to move from traditional data services to IP-based platforms to take advantage of applications and cost efficiencies. . . . Over the course of time, these IP connections may be the only network connections that businesses need.").

[7] As of the third quarter of 2003, consumers had obtained 20.7 million packet-switched broadband lines, and increasingly are using these lines to substitute for circuit-switched voice and data services. *See* J. Hodulik, *et al.*, UBS Investment Research, *High Speed Data Update for 3Q03* (Dec. 1, 2003); V. Shvets, *et al.*, Deutsche Bank Securities, *Wireline 4Q03 Preview: Calm Before the Storm* at 3 (Jan. 13, 2004) ("VoIP clearly is the key source of the RBOCs' latest bout of problems, with cable operators being the principal (but far from the only agent of change); J. Halpern, *et al.*, Bernstein Research, *Telecom and Cable: VoIP will Force Regulatory Lines to be Redrawn* at 11 (Nov. 13, 2003) ("We currently expect the RBOCs to lose significant primary line share to VoIP providers of all flavors.").

[8] Repeating arguments that the Commission rejected in connection with pricing flexibility for special access, AT&T complains (at 4) that SBC has failed to demonstrate that the Commission's rules "have posed any impediment to the reasonable rollout of any packet-switched service." As the Commission found: "Regardless of LECs' incentives to introduce new services, we conclude that the benefits of our current new services rules do not justify the delay caused by those rules, and we reject AT&T's argument. Elimination of the new services rules serves the Commission's goals of streamlining our regulations, removing unnecessary regulatory barriers, and increasing consumer choice." *Pricing Flexibility Order* ¶ 42. In any event, AT&T's claim rings hollow because the bulk of SBC's packet-switched services are provided through its separate data affiliate, ASI, which is subject to full forbearance from the Commission's tariffing requirements.

LEC has been granted permission . . . thus diminishing the incumbent's incentives to develop and offer new services." *Pricing Flexibility Order* ¶ 38.[9] This is obviously not what the Commission intended when it excluded packet-switched services from price-caps in 1990, and such policies make even less sense today. Many of the new and innovative services now being offered are packet-switched, and these services promise to deliver unprecedented levels of competition for all consumers.

Third, granting relief is necessary to ensure regulatory consistency – both as between SBC and other price-cap LECs, and as between packet-switched services and non-packet-switched services. As noted above, a number of other price-cap LECs already provide packet-switched services under price caps. Granting SBC's waiver is necessary to put SBC on the same footing as these similarly situated carriers, which is required by well-settled principles of administrative law.[10] Moreover, some of the packet-switched services that SBC and other carriers are now deploying are partial or full replacements for the circuit-switched and dedicated services that have been provided for many years. It would violate principles of regularity parity and technological neutrality to treat packet switches services differently from these older services merely because of the underlying technology.[11] This is particularly true because packet-switched

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[9] AT&T argues (at 5) that the Commission should deny SBC's petition because it "can seek and obtain a waiver of the Commission's tariff and pricing rules on case-by-case basis." But seeking approval on a case-by-case basis defeats the entire purpose of the price-cap rules, which is to eliminate the competitive disadvantage that price-cap LECs face when they are forced to give competitors advanced notice of new service offerings. And while that is obviously the advantage that AT&T seeks to maintain, its only justification – that the waiver would effectively grant SBC the relief its seeking in the various broadband proceedings – is nonsense. As discussed below, a decision to regulate packet-switched services under price caps in no way prejudges the issue whether to deregulate those services entirely.

[10] *See, e.g., Petroleum Communications v. FCC*, 22 F.3d 1164, 1172 (1994) ("We have long held that an agency must provide adequate explanation before it treats similarly situated parties differently.") (citing New Orleans Channel 20, Inc. v. FCC, 830 F.2d 361, 366 (D.C. Cir. 1987); Public Media Center v. FCC, 587 F.2d 1322, 1331 (D.C. Cir. 1978); Melody Music, Inc. v. FCC, 345 F.2d 730, 733 (D.C. Cir. 1965)).

[11] *See, e.g., Application for Review of BellSouth Wireless, Inc. Amendment of Parts 20 and 24 of the Commission's Rules – Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, Memorandum Opinion and Order, 12 FCC Rcd 14031 ¶ 14 (1997) ("[T]he requirements of regulatory parity require similar services to be treated similarly."); *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Order on Remand, 15 FCC Rcd 385, ¶ 2 (1999) ("Congress made clear that the 1996 Act is technologically neutral and is designed to ensure competition in all telecommunications markets").

services are, if anything, even more competitive than many of the services now under price-caps, and therefore should be subject to less regulation not more.

Despite all this, AT&T claims (at 12) that the 1990 rationale for excluding packet-switching services from price caps "is acutely applicable today" because these services are the subject of controversies that the Commission has not yet addressed. But this is directly contrary to the position that AT&T has taken in the past, where it has argued that packet-switched services *should be included* under price caps. In its comments opposing a request by US West to exclude frame relay service from the non-price-cap revenues it reported on an aggregated basis, AT&T claimed that it was bad enough that packet-switched services were excluded from price caps in the first place, and that any further "singl[ing] out" of these services should be avoided. *US West Petition for Waiver of the Tariff Review Plan Rules*, Memorandum Opinion and Order, 12 FCC Rcd 8343, ¶ 6 (1997). As the Commission explained, "AT&T emphasizes that the rules which allow for the exclusion of certain services from the price cap regulation are themselves a departure from the Commission's basic policy that 'capping all existing LEC service would yield the greatest [public] benefit,' and therefore are limited to a finite group of services that, among other things, 'represent a very small fraction of the LEC's federally-tariffed activities.'" *Id.* (citing AT&T Opposition at 3). The Commission "agree[d] with AT&T" and rejected US West's petition. *Id.* ¶ 11.

In any event, the controversial issues relating to the regulatory classification of packet-switched services has no bearing on whether it is appropriate to include these services under price caps, which the Commission already permits for other price-cap LECs. Rather, the issue the Commission is addressing elsewhere is whether to remove packet-switched services from Title II entirely, which would render the issues raised in this petition moot. And while AT&T argues that the Commission cannot properly decide the narrow issue raised by SBC's waiver until it decides these larger issues, it has it exactly backwards. As discussed further below, price-cap regulation is a transitional step on the way to full deregulation, and the Commission obviously need not decide issues relating to the latter before deciding the former. *See Pricing*

Flexibility Order ¶ 11 (price caps are a "transitional regulatory scheme until actual competition makes price cap regulation unnecessary").

AT&T also claims (at 5) that the requested relief will not eliminate the need to file cost-support information, because the packet-switched services at issue are loop-based services for which such information must be filed even in the case of new services. Even if this were true, it only hurts AT&T's case, as it merely demonstrates that granting SBC's petition would not eliminate some of supposed regulatory safeguards that AT&T claims should remain in place. In any event, the fact of the matter is that the more significant of the two existing services for which SBC is seeking relief – OPT-E-MAN – is not a loop-based service and would not require cost-support information.[12] The Commission's rules define a loop-based service as "[s]ubscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate interexchange service." 47 C.F.R. § 36.154(A), Subcategory 1.3; *id.* § 61.3 (yy). OPT-E-MAN, by contrast, uses an optical Ethernet network that is entirely separate from the public switched telephone network and, therefore, does not meet this definition.

IV. AT&T's Claims About Competition for Packet-Switching Services and Special Access Are Irrelevant and Wrong

Because it has no legitimate arguments with respect to the narrow waiver sought in SBC's petition – which is not even needed in the first place – AT&T attempts to mislead the Commission into thinking that granting SBC's petition would somehow prejudge the question whether the Bell companies have market power in the provision of broadband services, which "has not been decided and is squarely before the Commission in the *Dom/Non-Dom NPRM.*" AT&T at 3; *see id.* at 6-8. This is nonsense.

AT&T's argument boils down to the argument that only competitive services should be included under price caps, which has never been the Commission's policy and makes no sense. Price-cap regulation is not a reward that is handed out only when full competition is achieved,

[12] SBC's other existing packet-switched service for which it is seeking relief – BPON – is a limited offering to 6,000 residential units in San Francisco. It is also possible that many of the packet-switched services that SBC will introduce in the future will not be loop-based services.

but rather a mechanism for helping obtain that competition in the first place. *See, e.g., Pricing Flexibility Order* ¶ 11; *1990 Price Cap Order* ¶ 33. As the Commission has held, "[a]rguments that the provision of interstate access is not a competitive activity, and therefore as a policy matter we should not pursue incentive regulation of interstate access, ignore the benefits price cap regulation can provide to ratepayers." *1990 Price Cap Order* ¶ 33. Thus, the Commission may decide the issues in SBC's petition without reaching any of the issues that are now pending in the *Dom/Non-Dom NPRM.*

In any event, the provision of packet-switched services is highly competitive, and the Commission should accordingly remove these services entirely from Title II regulation. As the Commission has recognized, cable operators currently dominate the provision of mass-market broadband services.[13] While AT&T tries to get around this fact by attempting to manufacture an artificial wholesale market for broadband services, it has been black-letter law for more than half a century that a relevant product market must be defined to include *all* providers, including vertically integrated providers such as the dominant cable modem providers.[14] AT&T next claims that the incumbent LECs face no significant competition in the provision of broadband to small business customers, but it relies on hopelessly outdated evidence and ignores recent data that demonstrate significant competition for these customers as well.[15] AT&T also attempts to

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[13] *See, e.g., Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 262 (2003) ("*Triennial Review Order*").

[14] *See, e.g., AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 389 (1999) (faulting the Commission for failing to consider carriers that self-provide facilities in evaluating competitive alternatives); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 424-25 (2d Cir. 1945) ("*Alcoa*"); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986); *SBC Communications Inc. v. FCC*, 56 F.3d 1484, 1493-94 (D.C. Cir. 1995); *see also* U.S. DOJ, FTC, *Horizontal Merger Guidelines* § 1.31 (requiring that an Agency's identification of firms that participate in the relevant market begin with all firms that currently produce or sell in the relevant market, including "vertically integrated firms to the extent that such inclusion accurately reflects their competitive significance in the relevant market."); 2A Phillip E. Areeda, *et al.*, *Antitrust Law* ¶ 423, at 81-82 (2002) (self-suppliers that can easily switch production to serve other customers must be considered part of the relevant market).

[15] For example, a December 2003 study by In-Stat/MDR finds that cable modem service is now the *most used* broadband technology by both small businesses and small office/home office (SOHO) businesses. *See* K. Burney & C. Nelson, In-Stat/MDR, *Cash Cows Say 'Bye-Bye': The Future of Private Line Services in US Businesses (5+ Employees)* at 19, Table 9 (Dec. 2003). According to the study, nearly twice as many small businesses now use cable modem (44%) service as use ADSL (23%). *See id.* Moreover, with the advent of IP telephony services, cable has an even greater ability to attract small-business customers. *See, e.g.*, G. Campbell, *et*

obscure the fact that it and the other interexchange carriers dominate the provision of packet-switched services to large business customers, by focusing on the tiny segment of the market for purely local packet-switched services, which few large customers actually purchase in isolation.[16] And while AT&T claims that IXCs often provides packet-switched services using facilities obtained from ILECs, the fact that these carriers have nonetheless come to dominate the retail market is dispositive proof that they are able to obtain these inputs at competitive rates.

Finally, AT&T argues that granting SBC's petition "substantially increases the risk of higher special access rates." AT&T claims that SBC will (1) introduce packet-switched services into the special access basket, and then (2) lower the prices for those services -- despite the fact that AT&T contradictorily claims that such services are not competitive, in order to (3) raise the prices for other services such as special access. AT&T's gross speculation flies in the face of the fact that other Bell companies have been providing packet-switched services under price caps for years and there have been no reported instances of such conduct. Moreover, as the Commission has stated, the danger of incumbent LECs raising prices for services is, if anything, *greater* when they are permitted to introduce new services outside of price caps than under those caps. *See Pricing Flexibility Order* ¶ 43 ("We agree with MCI that the introduction of new services outside of price caps ultimately might enable price cap LECs to raise rates for both new services and existing services to unreasonable levels."). In any case, this is clearly not the proper forum to

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al., Merrill Lynch, *3Q03 Broadband Update: The Latest on Broadband Data and VoIP Services in North America* at 1 (Nov. 3, 2003) (IP telephony "could reinforce cable's lead in [high-speed data] and open the door to new market opportunities – for example, the small business sector."). The In-Stat/MDR study also shows that many small businesses are also making extensive use of fixed wireless (23%) and satellite (11%), and that more small business are now using fixed wireless than DSL.

[16] As one analyst has recently found, "ATM and frame relay services constitute the majority of telecom spending by businesses and nearly 85% of revenue opportunity within ATM and frame relay services is in long distance service offerings." Michael Bowen et al., Schwab Soundview Capital Markets, *AT&T Corp.* at 2 (Jan. 21, 2004) ("*Schwab*"); *see also Triennial Review Order* ¶ 302 ("Enterprise market customers . . . prefer a single provider capable of meeting all their needs at each of their business locations which may be in multiple locations in different parts of the city, state or country."). As of January 2004, AT&T, MCI , and Sprint together controlled 79 percent of the Frame Relay market and 60 percent of the ATM market. *See Schwab* at 3.

address AT&T's speculative concerns; "IXCs may file complaints under section 208 of the Act, should they believe that such unreasonable discrimination has occurred." *Id.* ¶ 41.[17]

V. CONCLUSION

For the reasons set forth above, the Commission should grant SBC's petition to include its packet-switched services under price cap regulation.

Respectfully Submitted,

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[17] Likewise, the Commission need not address AT&T's premature complaint (at 10) that SBC might attempt to obtain pricing flexibility for its packet-switched services, which it would be well within SBC's legal rights to do.